Hong Kong – a new administration and a new way forward?

The global business community has experienced several challenges this past financial year: the continuation of the European debt crisis and the resultant instability in world capital markets; concerns of a possible ‘hard or soft landing’ in China and the uncertainties surrounding the U.S. fiscal cliff and ballooning national debt.

Despite the global uncertainties that abound, the Asian region continued to generate growth that may be the envy of many developed countries. Hong Kong has not been immune from the effects of the global downturn with the growth for 2012 expected to be low. On the other hand, China’s growth rate remains strong at 7.8 percent in 2012. Concerns over a hard or soft landing in China are also easing on the back of reasonably strong GDP numbers and a renewed commitment by the Central Government to stimulate economic activity.

The structural reforms and increasing domestic consumption demand in many Asian countries are creating opportunities for multinational companies to expand into Asia. In 2012, we saw many multinationals look for acquisition opportunities throughout Asia in order to help drive their own growth ambitions.

Amidst all the global uncertainties, the Honourable CY Leung took up the post of Chief Executive for a five-year term in July 2012. The Chief Executive was elected on a platform that focused on housing, education, social welfare and improving the living and working environment for the people of Hong Kong. The Government also reinforced its commitment to the business community to maintain and enhance Hong Kong’s competitiveness and role as Asia’s leading financial and trading hub.

During the first six months of office, the new administration introduced various measures to address concerns over a shortage of housing and its affordability. The Government surprised many by announcing a new Buyers Stamp Duty of 15 percent and extending the application of the Special Stamp Duty rules.

On the international front, the Government continues to seek out new partners to enter into double tax agreements, introduced new rules to promote the use of Islamic financial products in Hong Kong and actively promoted Hong Kong as an offshore Renminbi centre.

Finally, the Government remains keen and interested in hearing from community representatives, businesses and industry bodies on how Hong Kong can improve its position as the leading financial and trading hub in Asia. KPMG continues to contribute to the debate by working closely with our clients to ensure their views on current issues are heard through the appropriate channels.

For more information about our tax services, please contact us or visit our website at kpmg.com/cn
Hong Kong Budget Summary
2013 - 2014

The information contained in the 2013-14 Hong Kong Budget Summary is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

Legislative proposals do not generally become law until their enactment and may be modified by the Legislative Council before enactment.

27 February 2013

It should be noted that the following information is presented in summary form and readers are advised to seek professional advice before formulating business decisions.
In the 2013-14 Budget, the Financial Secretary forecasts a consolidated budget surplus of HKD 64.9 billion for 2012-13 against an original estimate of a deficit of HKD 3.4 billion. The surplus is largely driven by increased revenues from land sales, tax collections, stamp duties and a greater than anticipated dividend from West Rail Property Development Limited. However, with the proposed increase in Government expenditure, the Government expects a small deficit of about HKD 4.9 billion in 2013-14.

The Financial Secretary noted that 2013 will be a challenging year. However, Hong Kong’s economy has survived a number of major challenges that threatened to bring external trade and economic growth to a standstill, take unemployment to an all-time high, and see investor confidence fall to an all-time low.

The Financial Secretary highlighted that actual Gross Domestic Product (GDP) growth for 2012 as a whole was only 1.4 percent, which was much lower than the average of 4.5 percent over the past 10 years. However, the forecast GDP growth for 2013 is between 1.5 percent and 3.5 percent. The Financial Secretary also noted that the measures to be introduced in the current Budget would have a stimulus effect of 1.3 percentage points, while the measures introduced in last year’s Budget had stimulated GDP growth of 1.5 percentage points. The measures introduced in the current Budget focus on four areas - developing the economy, optimising human resources, investing in infrastructure and caring for people’s livelihood.

Hong Kong’s fiscal reserves remain strong and are estimated to be HKD 734 billion by the end of March 2013, representing approximately 36 percent of GDP and is equivalent to 23 months of Government expenditure.

While no specific personal tax reductions were announced, one-off relief measures include a Salaries Tax reduction for 2012-13 of 75 percent capped at HKD 10,000, increases in the basic and additional child allowances from HKD 63,000 to HKD 70,000, and in the deduction ceiling for self-education expenses from HKD 60,000 to HKD 80,000. The Government also proposed a waiver of property rates capped at HKD 1,500 per quarter, a subsidy for residential electricity accounts of HKD 1,800, and several initiatives for low-income earners.

For businesses, the Financial Secretary proposed a one-off reduction of Profits Tax for 2012-13 of 75 percent capped at HKD 10,000 and a waiver of business registration fees.

These relief measures will help ease the pressure on the middle class, grass roots and small and medium enterprises (SMEs).
Taking a lead from the recent Policy Address, the Financial Secretary has indicated his intention to support the Chief Executive’s goal to increase public housing and develop new land to tackle the housing problem. However, initiatives such as increasing the housing supply arguably did not go far enough. KPMG had proposed, for example, the introduction of a primary home rental deduction, which appears to have fallen on deaf ears.

Separately, while the Government has affirmed its commitment to a health protection scheme, no concrete proposals have been put forward to achieve this. KPMG has advocated tax incentives to encourage the middle class to purchase health insurance in an effort to relieve the burden on public medical expenses. However, no such initiative has been adopted.

That said, the Government has forecast substantial capital expenditure mainly in the area of large infrastructure projects. This expenditure, estimated in the region of HKD 70 billion next year, would create around 75,000 job opportunities, which should further stimulate the domestic economy.

Against this, however, is the need to fund expenditure within the constraints of what remains a very narrow tax base. While this was acknowledged by the Financial Secretary, no clear guidance was provided as to how this might be addressed. A fundamental review of the tax base should be a priority of the Government.

It may also be the right time to consider, or reconsider, other tax-related initiatives, such as group loss relief and loss carryback, that have long been advocated by KPMG and other stakeholders. Key incentives to further entrench Hong Kong’s position as a global or regional hub and its reputation for innovation should also be evaluated. This could include the introduction of incentives for global/regional headquarters and/or service centres, as well as enhanced deductions for research and development expenditure.

All of these initiatives should support the four pillar industries - Trading and Logistics, Financial Services, Business and Professional Services and Tourism - for which the Government has emphasised its ongoing commitment in the current Budget.

The Financial Services industry will welcome certain key initiatives announced in the Budget. While the ‘devil will be in the detail’, it is extremely positive that certain key concerns of the fund management sector have been acknowledged. For example, the offshore funds exemption is to be extended to cover investments in some private companies and to facilitate Hong Kong as a place of domicile for open-ended funds. Initiatives to facilitate Mainland business in or through Hong Kong should further stimulate the fund management sector. Other initiatives such as promoting Hong Kong as a preferred centre in which to establish captive insurance business should provide further support to the Financial Services industry.
The significant progress made in expanding Hong Kong’s tax treaty network is acknowledged. Priority should now be given to enhancing relations with other key trading partners. Australia, India and Germany are examples of jurisdictions with which further developments would be welcomed.

At a domestic level, SMEs continue to form the backbone of the economy and additional support for them was announced in the Budget.

On the whole, the Budget was broadly in line with expectations and contained certain significant and welcome announcements. Unsurprisingly, but perhaps not unreasonably, the Budget was fairly cautious. There are many ways the Government could seek to stimulate the economy, including those described here, and we look forward to the Government seizing these opportunities and other initiatives going forward.
Profits Tax

Persons carrying on business in Hong Kong are liable to Profits Tax on profits arising in or derived from Hong Kong.

The Financial Secretary did not change the Profits Tax rates and allowances for 2013-14. However, in line with last year, a one-off reduction of 75 percent of Profits Tax for 2012-13 has been proposed, although with a reduced ceiling of HKD 10,000. The reduction will be reflected in the final tax payable for 2012-13.

The Profits Tax rate for corporations will remain at 16.5 percent for 2013-14 and for unincorporated businesses, it will remain at 15 percent.

The rate of deeming assessable profits from royalty type payments for the use of intellectual property will remain at 30 percent or 100 percent as the case may be of the payment. Therefore, the effective tax rate on such payments will remain at 4.95 percent or 16.5 percent for 2013-14.

Capital allowances

The Depreciation Allowance rates for plant and machinery remain unchanged at:

Initial Allowance : 60 percent of qualifying expenditure in the year the expenditure is incurred.
Annual Allowance : 10 percent, 20 percent or 30 percent on the written down value brought forward depending on the category to which the asset belongs.

Industrial Building Allowances also remain unchanged at:

Initial Allowance : 20 percent of qualifying expenditure.
Annual Allowance : 4 percent of qualifying expenditure.

The Commercial Building Allowance on qualifying expenditure remains at 4 percent per annum.

A full deduction is available for certain capital expenditure, such as expenditure on computer hardware and software as well as for certain other types of expenditure, which would otherwise be treated as capital in nature and non-deductible.

The 100 percent Profits Tax deduction for capital expenditure on environmentally-friendly machinery and equipment in the first year of purchase and the five-year depreciation period for environmentally-friendly installations, which are mainly ancillary to buildings introduced in 2008-09, is retained. The 100 percent Profits Tax deduction for capital expenditure incurred on environmentally-friendly vehicles in the year of purchase, which became effective in 2010-11, is also retained.
Capital expenditure on the purchase of the following intangible assets are deductible (at various rates):

- patent rights or rights to any know-how
- registered trademarks, copyrights and registered designs (with effect from the year of assessment 2011-12).

**Deductions for donations**
The ceiling for tax deductible charitable donations remains at 35 percent of assessable profits for 2013-14.

**Salaries Tax**

The Financial Secretary has proposed a one-off reduction of 75 percent of Salaries Tax (and tax under personal assessment) for 2012-13, subject to a ceiling of HKD 10,000. The reduction will be reflected in the final tax payable for 2012-13.

The tax charge for 2012-13 and 2013-14 is the lower of:

(a) net assessable income less charitable donations and allowable deductions at the standard rate; or
(b) net assessable income less charitable donations and allowable deductions and personal allowances, charged at the following progressive rates:

<table>
<thead>
<tr>
<th></th>
<th>Tax</th>
<th>HKD</th>
<th></th>
<th>Tax</th>
<th>HKD</th>
</tr>
</thead>
<tbody>
<tr>
<td>First HKD 40,000</td>
<td>2%</td>
<td>800</td>
<td>First HKD 40,000</td>
<td>2%</td>
<td>800</td>
</tr>
<tr>
<td>Next HKD 40,000</td>
<td>7%</td>
<td>2,800</td>
<td>Next HKD 40,000</td>
<td>7%</td>
<td>2,800</td>
</tr>
<tr>
<td>Next HKD 40,000</td>
<td>12%</td>
<td>4,800</td>
<td>Next HKD 40,000</td>
<td>12%</td>
<td>4,800</td>
</tr>
<tr>
<td>Balance</td>
<td>17%</td>
<td>Balance</td>
<td>Balance</td>
<td>17%</td>
<td></td>
</tr>
</tbody>
</table>

The standard rate of Salaries Tax for 2012-13 and 2013-14 is 15 percent.

The Financial Secretary has proposed an increase in the child allowances when calculating the tax payable at the progressive rates. This is intended to support individuals and families raising children.
**Personal allowances**

In addition to the child allowances available annually, an additional one-off allowance is available for each child in the year of birth. The Financial Secretary has proposed that the additional allowance be increased from HKD 63,000 to HKD 70,000.

The personal allowances for 2012-13 and 2013-14 are set out below:

<table>
<thead>
<tr>
<th></th>
<th>2012-13 HKD</th>
<th>2013-14 HKD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal allowances</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(basic)</td>
<td>120,000</td>
<td>120,000</td>
</tr>
<tr>
<td>(married)</td>
<td>240,000</td>
<td>240,000</td>
</tr>
<tr>
<td>Single parent allowance</td>
<td>120,000</td>
<td>120,000</td>
</tr>
<tr>
<td>Child allowances</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1st to 9th child (each)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Year of birth</td>
<td>126,000</td>
<td>140,000</td>
</tr>
<tr>
<td>- Other years</td>
<td>63,000</td>
<td>70,000</td>
</tr>
<tr>
<td>Dependent parent allowance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(aged 60 or above)</td>
<td>38,000</td>
<td>38,000</td>
</tr>
<tr>
<td>(aged between 55 and 59)</td>
<td>19,000</td>
<td>19,000</td>
</tr>
<tr>
<td>Dependent grandparent allowance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(aged 60 or above)</td>
<td>38,000</td>
<td>38,000</td>
</tr>
<tr>
<td>(aged between 55 and 59)</td>
<td>19,000</td>
<td>19,000</td>
</tr>
<tr>
<td>Additional dependent parent and grandparent allowances</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(aged 60 or above)</td>
<td>38,000</td>
<td>38,000</td>
</tr>
<tr>
<td>(aged between 55 and 59)</td>
<td>19,000</td>
<td>19,000</td>
</tr>
<tr>
<td>Disabled dependant (spouse/child/parent/grandparent/brother/sister) allowance</td>
<td>66,000</td>
<td>66,000</td>
</tr>
<tr>
<td>Dependent brother/sister allowance</td>
<td>33,000</td>
<td>33,000</td>
</tr>
</tbody>
</table>

Applying the above Salaries Tax rates and allowances, a family of four will have to earn more than HKD 3,830,000 in 2013-14 before paying tax at the standard rate.

**Tax deductions**

The following items are deductible in determining a person’s Salaries Tax liability:

**Mortgage relief**

Home mortgage interest payments are deductible against income subject to Salaries Tax. Owner-occupiers may claim a deduction for mortgage interest payments up to a maximum of HKD 100,000 per year for one property. The deduction can be claimed for up to 15 years.
Caring for the elderly
As an alternative to the allowance for maintaining a dependent parent/grandparent, a deduction up to HKD 76,000 is available for the expenses incurred in maintaining a dependent parent/grandparent in residential care.

Contributions to retirement schemes
A deduction up to the maximum of the mandatory annual contributions (currently HKD 15,000) payable under the Mandatory Provident Fund scheme is available for contributions made by employees to recognised retirement schemes and Mandatory Provident Fund schemes.

Self-education costs
A deduction is available for self-education expenses. The deduction is available in respect of fees for training courses run by approved institutions. The Financial Secretary has proposed that the deduction ceiling be increased from HKD 60,000 to HKD 80,000 per annum.

Charitable donations
A deduction of up to a maximum of 35 percent of assessable income is available for approved charitable donations.

Property Tax
The standard rate remains at 15 percent for 2013-14.

Property Tax is payable and is charged on the owner of any land or buildings situated in Hong Kong at the standard rate on the ‘net assessable value’ of such land or buildings. Generally, ‘net assessable value’ is calculated as the amount of rent receivable by the owner of the subject land or buildings (net of any rates, which are paid by the owner) less a statutory 20 percent allowance for repairs and outgoings.

There are several exemptions, notably for corporations carrying on business in Hong Kong.

Rates
Rates on properties remain at 5 percent of the rateable value throughout the territory, although rates will be waived in 2013-14 subject to a ceiling of HKD 1,500 per quarter.
Stamp Duty

Property transactions
No changes were proposed to the Stamp Duty rates and banding on property transactions in the budget, although significant changes were announced on 22 February. As part of these changes, the due date for Stamp Duty on non-residential properties was advanced from the date of conveyance to the date of signing the sale agreement. Further, the standard rates of Stamp Duty were, in most cases, doubled. The banding for 2013-14 is set out below:

<table>
<thead>
<tr>
<th>Property Consideration</th>
<th>HKD</th>
<th>HKD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exceeds 2,000,000</td>
<td>2,000,000</td>
<td>1.5%</td>
</tr>
<tr>
<td>2,000,000</td>
<td>2,176,470</td>
<td>30,000 + 20% of excess over 2,000,000</td>
</tr>
<tr>
<td>2,176,470</td>
<td>3,000,000</td>
<td>3.0%</td>
</tr>
<tr>
<td>3,000,000</td>
<td>3,290,330</td>
<td>90,000 + 20% of excess over 3,000,000</td>
</tr>
<tr>
<td>3,290,330</td>
<td>4,000,000</td>
<td>4.5%</td>
</tr>
<tr>
<td>4,000,000</td>
<td>4,428,580</td>
<td>180,000 + 20% excess over 4,000,000</td>
</tr>
<tr>
<td>4,428,580</td>
<td>6,000,000</td>
<td>6.00%</td>
</tr>
<tr>
<td>6,000,000</td>
<td>6,720,000</td>
<td>360,000 + 20% of excess over 6,000,000</td>
</tr>
<tr>
<td>6,720,000</td>
<td>20,000,000</td>
<td>7.5%</td>
</tr>
<tr>
<td>20,000,000</td>
<td>21,739,130</td>
<td>1,500,000 + 20% of excess over 20,000,000</td>
</tr>
<tr>
<td>21,739,130</td>
<td>21,739,130</td>
<td>8.5%</td>
</tr>
</tbody>
</table>

Lower rates may apply to Hong Kong permanent residents on the purchase of their only residential property.

In addition, Special Stamp Duty (SSD) is imposed on the sales price or market value of the property as at the date of sale (whichever is higher). SSD was originally introduced with effect from 20 November 2010. However, under proposed legislation, SSD is to be imposed at the following penal rates, with effect from 27 October 2012, depending on when the property is bought and sold.

<table>
<thead>
<tr>
<th>Property holding period</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>6 months or less</td>
<td>20%</td>
</tr>
<tr>
<td>more than 6 months but not exceeding 12 months</td>
<td>15%</td>
</tr>
<tr>
<td>more than 12 months but not exceeding 36 months</td>
<td>10%</td>
</tr>
</tbody>
</table>
SSD is effective for residential properties acquired on or after 27 October 2012 and resold within 36 months, and is in addition to the *ad valorem* rates of Stamp Duty already imposed (up to 8.5 percent). Both the seller and the buyer will be jointly and severally liable for paying the SSD.

A further Buyer’s Stamp Duty at 15 percent is payable on purchases of residential properties by non-natural persons, or by natural persons who are not permanent residents of Hong Kong.

**Sales and purchases of Hong Kong stock**
No changes were announced to the rate of Stamp Duty payable in respect of transfers of Hong Kong stock. This remains at an aggregate *ad valorem* rate of 0.2 percent of the actual consideration or the value of the stock as at transfer date, whichever is higher.

**Other Points of Interest**

**Relief measures**
Similar to last year, the Financial Secretary announced several one-off relief measures to meet the aspirations of different sectors. These measures include:

- Granting a subsidy of HKD 1,800 to each residential electricity account
- Paying two months’ rent for public housing tenants
- Providing an extra allowance, equal to one month’s payment, to recipients of Comprehensive Social Security Assistance and Old Age Allowance, Old Age Living Allowance and Disability Allowance
- Waiving business registration fees for 2013-14
- Allocating another HKD 100 million to extend short-term food assistance services, when necessary
- Giving all student loan borrowers who complete their studies in 2013 the option to start repaying their student loans one year after completion of their studies.

**Strengthening Hong Kong as a premier international asset management centre**
To attract more private equity funds to domicile in Hong Kong, the Government proposed to extend the Profits Tax exemption for offshore funds to include transactions in private companies, which are incorporated or registered outside Hong Kong and do not hold any Hong Kong properties nor carry out any business in Hong Kong.

The Government is also considering legislative amendments to introduce the Open-ended Investment Company, an increasingly popular form of investment vehicle used in the fund industry, in order to attract more traditional mutual funds and hedge funds to domicile in Hong Kong.

In addition, the Securities and Futures Commission is liaising with Mainland authorities regarding an arrangement for mutual recognition of funds. This arrangement will attract more
funds to establish in Hong Kong and help foster the development of those professional sectors engaged in the registration, investment management and sale of funds.

**Captive insurance companies**
To attract more enterprises to set up captive insurance companies in Hong Kong, the Financial Secretary proposed to reduce the Profits Tax rate on the offshore insurance business of captive insurance companies, such that they will enjoy the same tax concession currently available to reinsurance companies.

**Government Bond Programme**
To further promote the sustainable development of the bond market, the Financial Secretary proposed to expand the size of the Government Bond Programme from the current HKD 100 billion to HKD 200 billion.

The Government will launch additional inflation-linked retail bonds (iBond). iBond of up to HKD 10 billion will be issued in 2013-14 to Hong Kong residents under the Government Bond programme. Interest will be paid to bond holders once every six months at a rate linked to the inflation rate of the last half-year period.

**Stored value facilities and retail payment systems**
In view of the growing popularity of online and electronic payment platforms, the Government is considering possible amendments to the legislation to introduce a licensing regime for stored value electronic money and to empower the Hong Kong Monetary Authority to supervise the relevant retail payment systems.

**Support for Small and Medium Enterprises**
The Financial Secretary proposed to assist SMEs under the challenging external environment in various areas, including:

- Extending the application period for the special concessionary measures under the SME Financing Guarantee Scheme for one year to the end of February 2014
- Increasing the cumulative amount of the grant under the SME Export Marketing Fund from HKD 150,000 to HKD 200,000
- Setting up more Design Galleries in Mainland cities other than Beijing and Guangzhou to offer platforms for Hong Kong enterprises to showcase their products
- Introducing a ‘Small Business Policy’ (SBP) scheme by the Export Credit Insurance Corporation for Hong Kong enterprises with an annual business turnover of less than HKD 50 million. SBP policyholders will enjoy a waiver of the annual policy fee and up to 20 percent premium discount within a period of two years from 1 March 2013.
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